CERTIFICATE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1925

No. 790

THE UNITED STATES OF AMERICA

vs.

JOHN E. ZERBEY AND NATIONAL SURETY COMPANY

ON CERTIFICATE FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

FILED OCTOBER 29, 1925

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INDEX

	Original	Print
Certificate from United States Circuit Court of Appeals, Third Circuit	1	1
Statement of case	1	1
Questions certified	5	4
Judges' signatures	6	5
Clerk's certificate	7	5

1 In United States Circuit Court of Appeals for the Third Circuit

UNITED STATES OF AMERICA, PLAINTIFF BELOW, plaintiff in error, vs. JOHN E. ZERBEY AND NATIONAL SURETY COMPANY, a Corporation of the State of New York, defendants below, defendants in error	No. 3303 March term, 1925

In error to the District Court of the United States for the Middle District of Pennsylvania

Before Buffington, Woolley, and Davis, circuit judges.

Statement of case

In order to be guided to a proper decision of this case the Circuit Court of Appeals for the Third Circuit desires the instruction of the Supreme Court, and, therefore, under authority of section 239 of the Judicial Code, certifies two questions of law arising from the following facts:

Section 6 of the act of Congress of October 28, 1919, 41 Stat. 305, generally known as the national prohibition act, provides that, "No one shall manufacture, sell purchase, transport, or prescribe any liquor without first obtaining a permit from the commissioner so to do. * * *

2 "The commissioner may prescribe the form of all permits and applications and the facts to be set forth therein. Before any permit is granted the commissioner may require a bond in such form and amount as he may prescribe to insure compliance with the terms of the permit and the provisions of this title."

Treasury Decision 2940, as amended by Treasury Decision 2946, both promulgated by the Commissioner of Internal Revenue to carry into effect the foregoing as well as other statutory provisions, provided in article 15:

"(b) The applicant, before or at the time of filing application for permit, is required to furnish a bond, in duplicate, conditioned that he shall fully and faithfully comply with the laws of the United States now or hereafter enacted, and all regulations issued pursuant thereto, respecting the sale or use of distilled spirits or wines for other than beverage purposes. * * *

"(f) The basis of the penal sum of the bond, Form 738 or 738A, covering the use or sale of nonbeverage spirits, is $4.20 per proof gallon on the quantity of spirits which will be received during any quarterly period of the calendar year, plus the amount of nonbeverage spirits on hand at the end of the preceding quarter.

"The penal sum of bonds covering wines will be computed at the rate of $100 for each 200 gallons, or any fractional part thereof.

which will be received during any quarterly period of the calendar year, plus the amount on hand at the end of the preceding quarter.

"The penal sum of a bond to cover both nonbeverage spirits and wines shall be the aggregate sum of the amounts required for each: Provided, however, That the penal sum of any bond shall not be less than $1,000 nor more than $100,000."

Conformably with the cited regulations, John E. Zerbey, on January 23, 1920, applied for a permit "to sell distilled spirits and wines for other than beverage purposes to others holding like permits," and filed with his application a bond for $100,000, bearing the same date and executed upon Form 738. The bond reads as follows:

"Know all men by these presents, that John E. Zerbey of Summit Hill, Pa., as principal and National Surety Company of New York City, N. Y., as surety, are held and firmly bound unto the United States of America in the sum of one hundred thousand ($100,000.00) dollars, lawful money of the United States, for the payment whereof to the United States we bind ourselves, our heirs, executors, administrators, successors, or assigns, jointly and severally, firmly by these presents:

"Whereas the above-bounden principal has made application for a permit to use and sell distilled spirits and wines for other than beverage purposes at Summit Hill, Penna., in the 12th collection district of Pennsylvania:

"Now, therefore, the condition of this obligation is such that if the said principal shall fully and faithfully comply with all the requirements of the laws of the United States now or hereafter enacted and regulations issued pursuant thereto, respecting the sale or use of distilled spirits and wines, for other than beverage purposes, then this obligation to be void; otherwise to remain in full force and virtue."

3 Form 738, upon which the foregoing bond was executed, was prescribed by Treasury Decision 2940. This form of bond was originally prescribed in connection with the enforcement of the provisions of sections 15 and 16 of the food control act of 1917, promulgated as a part of Treasury Decision 2559, approved October 26, 1917.

Treasury Decision 2559 provides as follows:

"Any violations of these regulations will subject the offender to the penalty provided by the statute, to wit: A fine not exceeding $5,000, or imprisonment for not more than two years, or both, and to the pains and penalties denounced by the statute for violation of the internal revenue laws as well as to liability on his bond."

The quoted provisions of the Treasury Decision 2559 were continued in force by Treasury Decision 2940.

On January 26, 1920, the Federal Prohibition Commissioner, acting under and by virtue of the authority of the Commissioner of Internal Revenue, issued to Zerbey a permit on Form 1405 reciting:

"Application having been duly presented and approved, you are hereby authorized and permitted to sell intoxicating liquors for

other than beverage purposes, to wit: To others holding permits which confer authority to purchase and use intoxicating liquors for nonbeverage purposes. * * * This permit is granted under the conditions that the provisions of the national prohibition act, and regulations issued thereunder will be strictly observed."

By section 10 of the national prohibition act it is commanded that no person shall manufacture, purchase for sale, sell, or transport any liquor without making at the time a permanent record of the transaction, and the Commissioner of Internal Revenue is therein authorized to prescribe the form of such record. Pursuant to this authority the commissioner provided by section 58 of regulations, 60, issued under date of February 1, 1920, that:

"(e) All persons dealing in intoxicating liquors are required to keep Record 52 and supplementary Record 52, containing detailed entries covering all receipts and deliveries of liquor by them, and to keep a permanent file containing a copy of each permit to purchase upon which deliveries of intoxicating liquor are made to or by them."

With the aforesaid permit in his possession unrevoked, Zerbey, between March 6, 1920, and July 30, 1920, it is alleged, violated the condition of his bond in the following respects among others: He (a) failed and neglected to keep records of the sales made by him of distilled spirits, as provided in section 10 of the national prohibition act and section 58 of Regulations, 60; (b) sold and
4 disposed of a large quantity of distilled spirits for beverage purposes; (c) diverted a large quantity of distilled spirits to other than nonbeverage purposes, and (d) had in his possession upon his premises about 36 barrels of whiskey which had been withdrawn, for nonbeverage purposes only, from a bonded warehouse subsequent to the effective date of the national prohibition act, of which distilled spirits no record was kept by him as required by section 10 of the national prohibition act and by section 58 of Regulations, 60.

Notice of these breaches of the condition of the bond was given to Zerbey and to the National Surety Company and due demand was made upon them for the payment of the amount of the bond. No part of the sum demanded having been paid, the United States brought this action in the District Court against Zerbey and the Surety Company to recover the full penal sum of the bond, it being alleged in the statement of claim that said sum had been forfeited and was due and owing by the defendants to the United States by reason of the aforesaid breaches of the condition of such bond. The statement of claim contained no allegation of any damage or pecuniary loss sustained by the United States as a result of the alleged breaches of condition.

To the plaintiff's statement of claim, the defendants, jointly and severally, filed affidavits of defense, raising questions of law, which

under the Pennsylvania practice act constituted a demurrer, wherein they asked the judgment of the court upon the following questions of law:

"1. Even if the bond given by the defendants has been breached, the Government is not merely by virtue of any breach entitled to recover the full amount of the bond, that full amount being but the penal sum and the maximum limit of recovery; all that the Government can recover is a sufficient amount to indemnify it for its actual financial loss, injury, or damage suffered and incurred on account or by reason of such breach or breaches. * * *

"4. There can be no recovery in this suit on the bond sued on because it is not a forfeiture bond."

In a memorandum opinion the court stated, in substance, that the question involved was whether the breaches of the condition of the bond rendered the defendants liable for the full amount of its penal sum, or whether the recovery should be limited to the actual damages sustained by the obligee; that if the bond was a forfeiture bond the full penalty was incurred upon a breach of its condition and the action could be sustained provided the facts pertaining to the alleged breach were made to appear to the satisfaction of the court and jury, but if the bond was not a forfeiture bond the action could not be sustained, under the pleadings, as no pecuniary loss or damage was alleged to have been suffered by reason of the breaches charged. Although observing that the question had been variously answered and was not free from doubt, the court was persuaded to follow the decisions in certain cases which it cited, holding that the United States could not recover the full penal sum of a Form 738 bond, but only such loss or damage as it should establish had been sustained by it in consequence of the breach or breaches of the condition of such bond. The statutory demurrers were accordingly sustained and judgment was directed to be entered dismissing the action. To review that judgment the United States has brought the case to this court on writ of error.

The questions of law upon which the Circuit Court of Appeals desires the instruction of the Supreme Court are these:

Questions certified

(1) Is a bond conditioned upon compliance with the law of the United States and regulations issued pursuant thereto, respecting the sale or use of distilled spirits and wines for other than beverage purposes, given the United States by one to whom a permit to sell intoxicating liquors for other than beverage purposes has been issued under the provisions of section 6 of Title II of the national prohibition act and regulations promulgated thereunder, forfeitable upon breach of the condition in the full amount of its penal sum?

6 (2) Is recovery upon breach of the condition of such a bond given by one holding such a permit limited to actual damages sustained by the United States?

JOSEPH BUFFINGTON,
Circuit Judge.
VICTOR B. WOOLLEY,
Circuit Judge.
J. WARREN DAVIS,
Circuit Judge.

(Endorsements: 3303 Certificate of questions for submission to Supreme Court. Received and filed Oct. 7, 1925. Saunders Lewis, jr., clerk.)

1x In United States Circuit Court of Appeals

Clerk's Certificate

I, Saunders Lewis, jr., Clerk of the United States Circuit Court of Appeals, for the Third Circuit, do hereby certify the foregoing to be a true and faithful copy of the original certificate of questions for submission to Supreme Court in the case of [title omitted] on file, and now remaining among the records of the said court, in my office.

In testimony whereof, I have hereunto subscribed my name and affixed the seal of the said court, at Philadelphia, this 7th day of October, in the year of our Lord one thousand nine hundred and twenty-five and of the independence of the United States the one hundred and fiftieth.

[SEAL.] SAUNDERS LEWIS, Jr.,
Clerk of the U. S. Circuit Court of Appeals, Third Circuit.

(Indorsed on cover: File No. 31513. U. S. Circuit Court of Appeals, Third Circuit. Term No. 790. The United States of America vs. John E. Zerbey and National Surety Company. [Certificate.] Filed October 29th, 1925. File No. 31513.)

WASHINGTON : GOVERNMENT PRINTING OFFICE : 1926

In the Supreme Court of the United States

OCTOBER TERM, 1925

Nos. 120, 790

EPHRAIM LEDERER, FORMERLY COLLECTOR, ETC.

v.

MARY A. McGARVEY, EXECUTRIX, ETC.

THE UNITED STATES

v.

JOHN E. ZERBEY AND NATIONAL SURETY COMPANY, a Corporation of the State of New York

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ON CERTIFICATES FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

MOTION TO ADVANCE NO. 790 FOR ARGUMENT WITH NO. 120 AND TO HAVE BOTH CASES SET FOR HEARING ON A DAY CERTAIN

Comes now the Solicitor General and moves to advance case No. 790, *The United States* v. *John E. Zerbey and National Surety Company*, for oral argument with case No. 120, *Lederer, Formerly Collector*, v. *McGarvey, Executrix of O'Kane*, and to set both cases for hearing on Monday, March 1st next, or as soon thereafter as convenient to

the Court. This motion is based upon the following grounds:

Both cases are in this Court on certificate from the Circuit Court of Appeals for the Third Circuit and present precisely the same questions, namely, whether a permit bond on Form 738, executed under the National Prohibition Act and regulations made pursuant thereto, is a forfeiture bond so as to enable the United States to recover the full amount named in the bond in the event of a breach of its condition, or is a mere indemnity bond restricting recovery to the actual damages shown by the United States to have resulted to it from such breach.

In the *Lederer case* the action was begun in the District Court of the United States for the Eastern District of Pennsylvania by Francis O'Kane to recover from Ephraim Lederer, former Collector of Internal Revenue, certain revenue taxes and a penalty alleged to have been unlawfully assessed against the plaintiff by the defendant, acting as such Collector, and paid by the plaintiff under protest. Defending the action Lederer filed an affidavit of defense and counterclaim in which he conceded that all but a small part of the sum sued for by O'Kane had been unlawfully assessed, but nevertheless opposed any recovery on the ground that O'Kane had breached the condition of a permit bond executed by him on Form 738 and was accordingly indebted to the United States

in the full penal sum of the bond, which exceeded the amount of O'Kane's claim. A demurrer to this pleading was sustained by the District Court on the ground that the bond in question was a mere indemnity bond, for breach of which the United States could recover only such damages as it should show had been suffered by it in consequence of said breach, and as the affidavit of defense failed to allege any damage resulting from the breach it did not set up any valid counterclaim or defense to the action. Lederer elected to stand on his pleading, and as O'Kane did not press his claim for the small amount which Lederer insisted had been properly assessed, the District Court gave judgment for the plaintiff for the amount conceded by the defendant to have been illegally assessed. Upon writ of error sued out by Lederer the Circuit Court of Appeals certified to this Court the following questions:

> 1. Is a bond conditioned upon compliance with the law of the United States and regulations issued pursuant thereto, respecting the sale or use of distilled spirits and wines for other than beverage purposes, given the United States by one to whom a permit to sell intoxicating liquors for other than beverage purpose has been issued under the provisions of Section 6 of Title II of the National Prohibition Act and regulations promulgated thereunder, forfeitable upon breach of the condition in the full amount of its penal sum?